

# Are You Measuring Your True Worth?

**H**ow do you measure the value of a company? Is it merely the assets or some other quantity reflected in the numbers on a balance sheet? Could it be that the true worth of a company cannot be determined using only traditional accounting measures? In their book *Intellectual Capital: Realizing Your Company's True Value by Finding Its Hidden Roots* (Harper Business, 1997), Leif Edvinsson and Michael S. Malone explain one of the greatest challenges facing any business today—the gap between its balance sheet and its market valuation.

Intellectual capital (IC) does not readily lend itself to definition. Though new as a theory, it has been in practice for years embodied in common sense. Its description could include everything from individual skills and know-how to information technology systems, trademarks, designs, customer franchises, and relationships with suppliers.

The book illustrates the role of IC using the metaphor of a tree. Organizational charts, annual reports, quarterly statements, company brochures, and other documents provide information on the tree's trunk, branches, and leaves. These are the things that are visible to the observer, that are known to the marketplace, and that are articulated in the accounting process. The fruit produced by the tree represents products that, when consumed by the customers, create a profit.

But there is more to the tree than what is visible. There is a large mass underground in the root system, and this represents the tree's hidden value. Healthy roots are required for the tree

to flourish and bear quality fruit. The quality of a company's business organization and the strength of its financial capital are functions of its hidden values. When you nurture these roots, the company will flourish. If you allow them to wither or become damaged, the company will eventually topple and die—even if it appears strong.

By understanding what is happening with the roots, you can estimate how healthy the tree will be in the years to come. This is particularly valuable when the climate is unstable. A tree in the prime of life may be under attack by parasites just underground that, if left unchecked, could eventually kill it. Strong roots may make the difference in surviving an unexpected drought or freeze. IC concerns itself with the roots of a company's value. It seeks to measure those hidden dynamic factors that underlie the visible company of buildings and products.

What are these hidden values—the roots of the company? According to Edvinsson and Malone, they take three basic forms: human capital, structural capital, and customer capital.

The company does not own human capital. Rather this capital comprises the sum total of the knowledge, skill, innovativeness, creativity, and ability of the individual employees who go about the company's business. This heading also includes the company's values, culture, and philosophy.

Structural capital can be owned and traded. It comprises hardware, software, databases, organizational structure, patents, trademarks, and everything else that supports the productivity of employees. Structural capi-

tal could be described as the infrastructure supporting human capital, the physical systems used to transmit and store intellectual material. Human capital is what builds structural capital, but the better your structural capital, the better your human capital is likely to be.

Customer capital encompasses measures of customer satisfaction. It looks at how long customers have been doing business with a firm, how sensitive the customers are to changes in price, and how healthy those customers are financially.

The book goes on to describe a process whereby IC can be used to visualize and depict the hidden assets of a business. The method is useful in creating a yardstick that can be used by those who manage, work for, or invest in a given organization. It provides a new perspective on the true worth of an organization. Understanding the strengths and weaknesses of your IC will keep your company's root system strong and healthy. Do not make the mistake of neglecting your most valuable assets.

—Jeffrey S. Russell, P.E., Ph.D.

## Errata

There were two errors in the article "Partnering in Construction: Improvement through Integration and Collaboration" by Sevda Bayramoglu, which was published in the July issue. First, through an editing error a reference was made to the author as a male rather than as a female. Second, a figure referenced in the article was inadvertently omitted. The figure appears on the following page. We regret the errors. **IME**

